

Commissioner's Directive #14
(Revised)
August 20, 1990

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Subject: Financial Institutions Tax

Introduction

The purpose of this Directive is to present an overview of Indiana's most recent addition to its tax structure, which was originally enacted in 1989 and amended by the General Assembly in 1990. This overview is intended to highlight the major areas of the new law and promote a general understanding of its basic principles.

The Department has been mandated to publish Regulations for the new tax before January 1, 1991. The Department distributed a proposed draft of the Regulations on June 19, 1990. Written comments from practitioners were requested to be submitted by July 25, 1990. The public hearing on the proposed regulations will be held on September 24, 1990 at 9:00 A.M. in Room 431 of the State House.

Authority

House Enrolled Act 1625 (1989) added a new Article to Indiana's Code which provides a franchise tax measured by net income for corporations transacting the business of a financial institution in the state of Indiana (IC 6-5.5). The new law is effective for taxable years that begin after December 31, 1989. Any holding company or regulated financial corporation with a fiscal year beginning before and ending on or after January 1, 1990 may continue to report and pay tax liability in accordance with Indiana law prior to the 1989 enactment of the franchise tax. Any holding company or regulated financial corporation with a fiscal year beginning before and ending on or after January 1, 1990 may begin reporting under IC 6-5.5 by either: 1) changing the corporation's fiscal year to a calendar year beginning January 1, 1990 and filing a final short year return for the tax under IC 6-2.1, IC 6-3 and IC 6-5; or 2) filing the final short year return for the tax under IC 6-2.1, IC 6-3 and IC 6-5 without changing the corporation's fiscal year. If either of the above two methods are utilized, a short year return would then be filed under IC 6-5.5 for the period from January 1, 1990 to the end of the corporation's fiscal year. HEA 1395 Section 30. The tax is imposed at a rate of 8.5%.

Any taxpayer which is taxable under IC 6-5.5, is exempt from Indiana's gross and adjusted gross income tax as well as the financial institutions tax under IC 6-5. IC 6-5.5-9-4.

The new law extends Indiana's tax jurisdiction to both resident and nonresident financial institutions and to all corporate entities that transact the "business of a financial institution" in Indiana regardless of where such entity is domiciled.

New Nexus Rules

IC 6-5.5 adopts an economic presence method for determining the jurisdictional basis for taxing nonresidents who conduct the business of a financial institution in Indiana.

"The Business of a Financial Institution"

Two categories of activities constitute the "business of a financial institution" for the purposes of the franchise tax. The first category encompasses the activities of traditional financial institutions. IC 6-5.5-1-17-(d)(1). The second category includes any corporation which derives 80% of its income from making loans and extending credit.

If a transaction is treated as a lease for federal income tax purposes, the leasing transaction is not the economic equivalent of extending credit for purposes of the 80% test. IC 6-5.5-1-17(d)(2)(B). However, for purposes of the 80% test, extending credit not only includes credit card operations, but pursuant to the 1990 amendments, also includes debit card, charge card and similar business. IC 6-5.5-1-17(d)(2)(C).

Taxpayers

The term "taxpayer" includes regulated financial institutions, their holding companies and the subsidiaries of either, as well as any other corporation (including entities taxed as a corporation under the Internal Revenue Code) organized under the laws of the United States, Indiana, another taxing jurisdiction or a foreign government, which is carrying on the business of a financial institution. IC 5.5-1-17(a).

Taxpayers are differentiated on the basis of their resident or nonresident status. A resident taxpayer is a taxpayer which is commercially domiciled in Indiana and transacts the business of a financial institution in this State. If a taxpayer is a resident taxpayer, all income received by the taxpayer is automatically attributable to Indiana and such income is subject to the financial institutions tax.

A nonresident taxpayer is a taxpayer which is not commercially domiciled in Indiana but transacts the business of a financial institution in this State. IC 6-5.5-1-4. Chapter 3 of IC 6-5.5 establishes the rules for determining when the activities of nonresident corporations constitute transacting business in Indiana. A taxpayer is transacting business in Indiana for the purposes of the franchise tax when it satisfies any of the following eight tests:

- (1) maintain an office in Indiana;
- (2) has an employee, representative or independent contractor conducting business in Indiana;
- (3) regularly sells products or services of any kind or nature to customers in Indiana that receive the product or service in Indiana;
- (4) regularly solicits business from potential customers in Indiana;
- (5) regularly performs services outside Indiana that are consumed within Indiana;
- (6) regularly engages in transactions with customers in Indiana that involve intangible property, including loans, but not property described in section 8(5) of this chapter, and result in receipts flowing to the taxpayer from within Indiana;
- (7) owns or leases intangible personal or real property located in Indiana; or
- (8) regularly solicits and receives deposits from customers in Indiana.

Only a portion of a nonresident taxpayer's income is subject to the tax. The statute employs a single factor receipts formula to determine the percentage of the nonresident taxpayer's income which is taxable. The single factor receipts formula is derived by dividing the gross receipts attributable to transacting business in Indiana by the taxpayer's total receipts from transacting business in all taxing jurisdictions.

Exemptions and Exclusions

Four specific types of corporations are exempted from the franchise tax:

- (1) Insurance companies subject to the tax under IC 27-1-18-2 or IC 6-2.1;
- (2) International banking facilities (as defined in Regulation D of the Board of Governors of the Federal Reserve System);
- (3) Any corporation that is exempt from income from tax under Section 1363 of the Internal Revenue Code; and
- (4) not-for-profit corporations. IC 6-5.5-2-7.

An exclusion is also provided for those financial institutions whose Indiana activities are limited to certain activities. These activities include owning an interest in the following types of

property, including those activities within Indiana that are reasonably required to evaluate and complete the acquisition or disposition of the property, the servicing of the property or the income from the property, the collection of income from the property, or the acquisition or liquidation of collateral relating to the property:

- (A) An interest in a real estate mortgage investment conduit, a real estate investment trust, or a regulated investment company (as those terms are defined in the Internal Revenue Code).
- (B) An interest in a loan-backed security representing ownership or participation in a pool of promissory notes or certificates of interest that provide for payments in relation to payments or reasonable projections of payments on the notes or certificates.
- (C) An interest in a loan or other asset in which the interest is attributed in IC 6-5.5-4-4, IC 6-5.5-4-5 and IC 6-5.5-4-6 and in which the payment obligations were solicited and entered into by a person that is independent and not acting on behalf of the owner.
- (D) An interest in the right to service or collect income from a loan or other asset from which interest on the loan or other asset is attributed in IC 6-5.5-4-4, IC 6-5.5-4-5 and IC 6-5.5-4-6 and in which the payment obligations were solicited and entered into by a person that is independent and not acting on behalf of the owner.
- (E) An amount held in an escrow or a trust account with respect to property described in this subdivision.

IC 6-5.5-3-8(5)

Method of Filing Returns

The statute permits taxpayers to report on a separate or a combined basis. Members of a unitary group file collectively on one combined return. No provision is made for filing consolidated returns.

Combined Returns

A taxpayer is allowed to file a separate return only in those instances where the taxpayer is not a member of a unitary group as defined in IC 6-5.5-1-18. If the taxpayer is a member of a unitary group, combined reporting is mandatory. However, if the taxpayer determines that its Indiana income is not accurately reflected by the filing of a combined return, then the taxpayer may petition the Department by indicating on its annual return,

that the return is a separate return made by a member of a unitary group. Such petition is subject to approval by the Department.

If a combined return is warranted, each taxpayer which is a member of a unitary group is obligated to file a combined return which includes all operations of the unitary business, but the unitary group should collectively file one return. IC 6-5.5-5-2; IC 6-5.5-6-1. The statute requires that the combined return include the adjusted gross income of all members of the group. See IC 6-5.5-5-2. The statute provides an exclusion for the income of corporations or other entities organized in foreign countries, except a federal or State branch of a foreign bank or its subsidiary which transacts business in Indiana. IC 6-5.5-5-2. In other words, combined reporting is on a water's edge basis.

The term "unitary business" is defined as business activities or operations that are of mutual benefit, dependent upon, or contributory to one another, individually or as a group, in transacting the business of a financial institution. IC 6-5.5-1-18(a). The term may be applied within single entity or between multiple entities and without regard to whether each entity is a corporation, a partnership or a trust.

The term "unitary group" is defined as those entities that are engaged in the unitary business wholly or, partially within Indiana. IC 6-5.5-1-18(a). Unity is presumed if there is unity of ownership, operation or unity of use as evidenced by centralized management, centralized purchasing, advertising, accounting or other controlled interaction among entities that are members of the unitary group as defined in IC 6-5.5-1-18(a). In other words, members of a unitary group are limited to those members who meet the definition of "taxpayer" for purposes of IC 6-5.5. IC 6-5.5-1-18(b).

Unity of ownership exists for a corporation if it is a member of a group of two or more business entities, 50% of whose voting stock is owned by a common owner or owners or by one or more of the member corporations of the group. IC 6-5.5-1-18(c).

Resident Taxpayer Computation

Resident taxpayers, with the exception of credit unions and investment companies, compute the franchise tax as follows:

Federal Taxable Income (I.R.C. Section 63)	_____
ADD:	
A. Deduction/losses included on federal income tax return not allowed on the Indiana return:	
(1) Net operating loss (NOL)	_____
(2) Net capital losses	_____
(3) Bad debt deductions	_____
(4) Charitable contributions	_____
(5) State income and franchise taxes	_____
(6) State and local property taxes	_____
B. Interest income on state and municipal obligations not included in federal taxable income	_____
DEDUCT:	
A. Bad debts actually charged off	(_____)
B. Associated expenses to carry state and municipal obligations (I.R.C. Section 265)	(_____)
C. Bad debt reserve transition adjustment included in federal taxable income because of a tax accounting method change	(_____)
Indiana Adjusted Gross Income	=====
DEDUCT:	
*A. Indiana net operating losses (NOL)	(_____)
**B. Indiana net capital losses (deductible to the extent of net capital gains)	(_____)
Indiana Taxable Income	_____
Tax Rate	X 8.5%
Tax before Credits	_____
Less:	
*** A) Credit for taxes actually paid to other states	(_____)
B) Other credits	(_____)
Indiana Franchise Tax Liability	=====

* For purposes of Indiana's NOL, if there is a negative taxable income when the franchise taxable income is determined, the same may be carried forward. Such carryforward must be incurred after December 31, 1989 and may be carried forward 15 years. Losses are not carried back. NOL's available on December 31, 1989 cannot be carried forward. IC 6-5.5-3-1(b)-(c).

** The taxpayer's net capital loss for the taxable year equals the taxpayer's net capital losses for the taxable year minus the net capital gains for each taxable year beginning after December 31, 1989. A net capital loss for a taxable year may be carried forward to each of the five (5) succeeding taxable years.

*** (a) A resident taxpayer or a resident member of a unitary group is entitled to a credit against the tax due under this article.

(b) The amount of the credit equals the lesser of:

- (1) The amount of creditable tax actually paid by the resident taxpayer or member to any other taxing jurisdiction on the resident taxpayer's or member's adjusted gross income; or
- (2) An amount equal to the amount of creditable tax that would be due at the tax rate set forth under this article on the lesser of:

(A) the taxpayer's adjusted gross income that is subject to taxation by the other taxing jurisdiction; or

(B) the taxpayer's adjusted gross income that is attributable to the other taxing jurisdiction under the rules for attributing gross receipts under this article.

(c) As used in this section, "creditable tax" means in the case of a taxing jurisdiction that:

(1) measures its tax using net income:

(A) a direct net income tax; or

(B) a franchise or other tax measured by net income; or

(2) is not covered by subdivision (1):

(A) a tax based on deposits, investment capital or shares, net worth or capital, or a combination of these tax bases; or

(B) any other tax that is imposed instead of an income tax.

IC 6-5.5-2-5.

**** Other credits include: teacher summer employment credit; credit for donations of high technology equipment to schools; investment credits; enterprise zone loan interest credit; industrial recovery tax credit; credit for enterprise zone adjusted gross income; neighborhood assistance credit; and alcohol and substance abuse credit.

In the case of a credit union, "adjusted gross income" for a taxable year means the total transfers to undivided earnings minus dividends for that taxable year after statutory reserves are set aside under IC 28-7-1-24.

In the case of an investment company, "adjusted gross income" means the company's federal taxable income multiplied by the quotient of:

1. the aggregate of the gross payments collected by the company during the taxable year from old and new business upon investment contracts issued by the company and held by residents of Indiana; divided by
2. the total amount of gross payments collected during the taxable year by the company from the business upon investment contracts issued by the company and held by persons residing within Indiana and elsewhere.

IC 6-5.5-1-2(c).

Nonresident Taxpayer Computation

Nonresident taxpayers, with the exception of credit unions and investment companies, compute the franchise tax as follows:

Federal Taxable Income (I.R.C. Section 63)	_____
ADD:	
A. Deduction/losses included on federal income tax return not allowed on the Indiana return:	_____
(1) Net operating losses (NOL)	_____
(2) Net capital losses	_____
(3) Bad debt deductions	_____
(4) Charitable contributions	_____
(5) State income and franchise taxes	_____
(6) State and local property taxes	_____
B. Interest income on state and municipal obligations not included in federal taxable income	_____
DEDUCT:	
A. Bad debts actually charged off	(_____)
B. Associated expenses to carry state and municipal obligations (I.R.C. Section 265)	(_____)
C. Bad debt reserve transition adjustment included in federal taxable income because of a tax accounting method change	(_____)
<u>Indiana Adjusted Gross Income</u>	=====
Apportionment factor: <u>receipts attributable to Indiana</u> total receipts	= % _____
Indiana Adjusted Gross Income	_____
DEDUCT:	
* Indiana net operating losses (NOL)	(_____)
** Indiana net capital losses (deductible to the extent of net capital gains)	(_____)
Indiana Taxable Income	_____
Tax Rate	X 8.5%
Tax before Credits	_____
*** Less: Nonresident taxpayers credit	(_____)
Indiana Franchise Tax Liability	=====

*Indiana's net operating loss (NOL) for the nonresident taxpayer is multiplied by the apportionment factor. If there is a negative taxable income when the franchise taxable income is determined, the same may be carried forward. Such carryforward must be incurred after December 31, 1989 and may be carried forward 15 years. Losses are not carried back. NOLs available on December 31, 1989 cannot be carried forward. IC 6-5.5-2-1(b)-(c).

**A taxpayer's Indiana net capital loss for the taxable year equals the taxpayer's net capital losses for the taxable year minus the net capital gains for the year multiplied by the apportionment percentage applicable to the taxpayer under IC 6-5.5-2 for the taxable year of the loss. A net capital loss for a taxable year may be carried forward to each of the five (5) succeeding taxable years.

***(a) A nonresident taxpayer is entitled to a credit against the tax due under this article for the amount of net income tax due to the nonresident taxpayer's domiciliary state for a taxable year if:

- (1) the receipt of interest or other income from a loan or loan transaction is attributable both to the taxpayer's domiciliary state under that state's laws and also to Indiana under IC 6-5.5-4; and
 - (2) the principal amount of the loan is at least two million dollars (\$2,000,000).
- (b) the amount of the credit for each taxable year is the lesser of:
- (1) the portion of the net income tax actually paid by the nonresident taxpayer to its domiciliary state that is attributable to the loan or loan transaction; or
 - (2) the portion of the net income tax due to Indiana under this article that is attributable to a loan or loan transaction. The amount of tax attributable to a loan or loan transaction is the portion of the total tax due to each state in an amount equal to the same proportion as the receipts from the loan or loan transaction bear to the taxpayer's total receipts.

IC 6-5.5-2-6.

In the case of a nonresident credit union, "adjusted gross income" for a taxable year means the total transfers to undivided earnings minus dividends for that taxable year after statutory reserves are set aside under IC 28-7-1-24 multiplied by their apportionment factor.

In the case of a nonresident investment company, "adjusted gross income" means the company's federal taxable income multiplied by the quotient of:

1. the aggregate of the gross payments collected by the company during the taxable year from old and new business upon investment contracts issued by the company and held by residents of Indiana; divided by

2. the total amount of gross payments collected during the taxable year by the company from the business upon investment contracts issued by the company and held by persons residing within Indiana and elsewhere.

IC 6-5.5-1-2(c).

Payment of the Tax

The new franchise tax is payable directly to the Indiana Department of Revenue. Payment of the quarterly estimated tax must be accompanied by quarterly vouchers provided by the Department.

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Commissioner